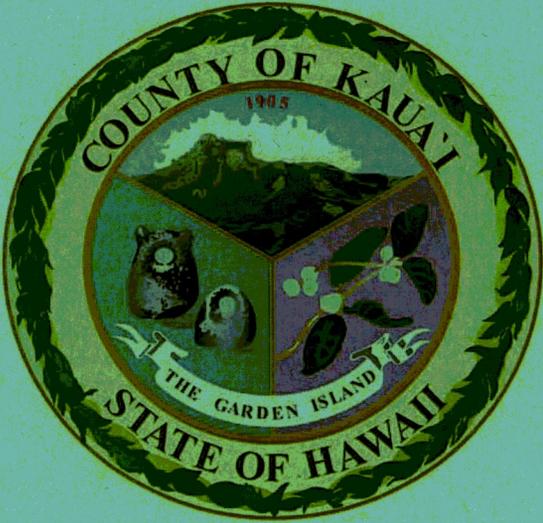


**MANAGEMENT ADVISORY  
REPORT**

**County of Kaua'i, Hawai'i**



**For the Fiscal Year Ended  
June 30, 2012**

C-2013-28

P-201.1

**COUNTY OF KAUA'I**

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To the Chair and Members of the County Council  
County of Kaua'i  
Lihue, Kaua'i, Hawai'i

In planning and performing our audit of the financial statements of the County of Kaua'i, State of Hawaii (the County) as of and for the fiscal year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the County's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

However, during our audit, we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this report summarizes our current findings and recommendations regarding these matters. This letter does not affect our report dated December 12, 2012, on the financial statements of the County.

*N&K CPAs, Inc.*

Honolulu, Hawai'i  
December 12, 2012

## **CURRENT FINDINGS AND RECOMMENDATIONS**

### **12-01 Review Purchasing and Procurement Process For Independent Contractors**

The Anti-Drug Program (Program) entered into an independent contractor agreement for services with an individual and her company, pursuant to a request for services exemption from civil service under Hawaii Revised Statutes (HRS) §76-77. The Program compiled a scope of work for the independent contractor to assist with completing a portion of the Strategic Prevention Framework State Incentive Grant (SPF-SIG), a federally funded grant the County has been awarded from the State Department of Health.

During our audit, we noted that prior to the execution of the independent contractor agreement, there was no determination of the availability of funds (as required by Section 19.18.B. of the County Charter) and the tax clearance and certificate of good standing was not obtained. The Department of Finance, Purchasing Division determined that the error was attributed to unintended procedural omission and provided the Program coordinator information and guidance about the proper procedures.

Furthermore, it was unclear as to whether the contracted services were exempt from the County's procurement process as the contract appeared to be for professional services of approximately \$40,000. Use of federal funds requires compliance with the federal program requirements, including procurement procedures. Through our review of the contract file, the Program claimed exemption under HRS §76-77; however, this is not a qualified exemption from procurement under HRS Section 103D-102.

#### **Recommendation**

The County should review its process for independent contractors to ensure that proper procurement procedures are adhered to. The County should also review its procedures for the issuance of these independent contracts to ensure compliance with the State and County procurement code.

## 12-02 Improve Internal Controls Over the pCard Purchases

In February 2012, the County started issuing purchase cards (pCard) to several departments and agencies for handling small purchases (less than \$1,500). The procedures for using the pCard did not change the existing procurement procedures. The County's policy requires that any purchase made by the pCard must be preapproved by the respective pCard coordinator and documentation of quotes for purchases over \$500 were still required procedures.

During our audit of 40 pCard transactions during the fiscal year ended June 30, 2012, we noted the following:

- The County does not have a standardized form that allows for documentation of the preapproval of pCard transactions.
- We noted five instances where there was no evidence that the purchase was approved prior to it being made.
- We noted three instances where the documentation provided noted that the purchase was verbally preapproved.
- We noted five instances where the approval was done after the purchase was made.
- We noted one instance where the pCard user did not get approval for the transaction because the user thought that no approval was needed for purchases under \$50.

The County currently requires the respective departments and agencies to self-report any procurement violations to the Division of Purchasing. Other than the self-reporting of violations, the County does not have a monitoring control to ensure that the departments and agencies are following the purchasing procedures. Subsequent to the issuance of the pCards to the departments and agencies, the County has not performed procedures to determine whether there is compliance with the County's policies and procedures.

### **Recommendation**

The County should review its policies and procedures and strengthen internal controls over the use of the pCard. These policies and procedures could include mandatory training for all personnel handling pCard transactions at the various departments and agencies; continuous monitoring of pCard transactions to ensure proper procurement procedures are followed; and implementation of violation reports and consequences for departments and agencies not following the established procedures.

**12-03 Properly Account for Contingencies**

The County contracted the operation and management of the metal and automobile recycling center on land that the County had leased from a private land owner. In May 2009, the County became aware of operational deficiencies at the site because the contracted company was improperly operating the recycling center, in violation of the Department of Health permit. In April 2011, the County was notified by the land owner that the license agreement was being terminated and that the County was responsible to undertake actions to remedy the situation. In February 2012, the County was invoiced \$119,563 by the land owner for the partial clean up of the property.

During our audit, we noted that the County had conducted an environmental study of the clean up alternatives and the related costs. The County received a draft of the study dated July 2012. We also noted that this contingency was not included in the County's accounting system for outstanding claims and judgments accrued for the fiscal year ended June 30, 2012. After further discussion with County personnel, it was determined that the loss contingency was probable and that the amount could be estimated. Loss contingencies that are considered to be probable and can be reasonably estimated should be accrued for in the financial statements. After discussion with County personnel, the County subsequently recorded a \$2.1 million liability for the loss contingency.

**Recommendation**

The County should establish procedures to ensure that loss contingencies are properly accounted for and is timely communicated to the Accounting Division for proper accrual in the County's financial statements.

**STATUS OF PRIOR YEAR'S RECOMMENDATIONS**

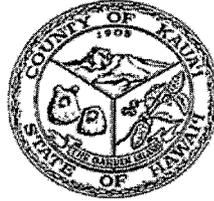
**County of Kaua'i, Hawai'i**  
**STATUS REPORT**  
**Fiscal Year Ended June 30, 2012**

This section contains the current status of our prior audit recommendations. The recommendations are referenced to the pages of the management advisory report for the fiscal year ended June 30, 2011, dated December 15, 2011.

Recommendations	Status
<p><b>11-01 REVIEW TREASURY TRUST ACCOUNTS</b> (page 4)</p> <p>The County should determine the proper disposition of the older balances held in the treasury trust accounts and implement procedures to require timely follow up on aging deposits. In addition, the County should review the use of the Planning Treasury Trust to ensure that the transactions recorded in the account are proper and determine who the balance in the account is being held for.</p>	<p>Partially accomplished. The departments have begun the process of reviewing the older balances to determine the proper disposition of the funds.</p>
<p><b>11-02 IMPROVE SEWER BILLING PROCESS</b> (page 5)</p> <p>The County should review the current process used for billing for the commercial sewer charges and determine whether it is feasible for the Department of Water to include the sewer charges in their billing process. This would help improve the timeliness of the billings and reduce the potential for billing errors.</p>	<p>Partially accomplished. The Wastewater Management Division is reviewing the options and feasibility of alternatives for making the transition to timelier billing, with input from the Finance and Water Departments and others in County Administration.</p>

**CORRECTIVE ACTION PLAN**

**Bernard P. Carvalho, Jr.**  
Mayor



**Wallace G. Rezentes, Jr.**  
Director of Finance

**Gary K. Heu**  
Managing Director

**Sally A. Motta**  
Deputy Director of Finance

**DEPARTMENT OF FINANCE**  
**County of Kaua'i, State of Hawai'i**  
4444 Rice Street, Suite 280, Lihu'e, Hawai'i 96766  
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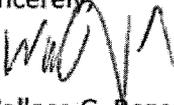
December 12, 2012

Ronald T. Shiigi  
N & K CPAs, Inc.  
American Savings Bank Tower  
1001 Bishop Street, Suite 1700  
Honolulu, HI 96813-3696

Dear Mr. Shiigi:

Attached are the County of Kaua'i's responses and corrective action plans related to your fiscal year 2012 audit report *Management Advisory Report's Current Finding and Recommendations*. We appreciate the opportunity to comment on the audit report.

Sincerely,

  
Wallace G. Rezentes Jr.  
Director of Finance

Attachment

*An Equal Opportunity Employer*

**Ref No. 12-01                      REVIEW    PURCHASING    AND    PROCUREMENT    PROCESS    FOR  
INDEPENDENT CONTRACTORS**

**Auditor's Recommendation:**                      The County should review its process for independent contractors to ensure that proper procurement procedures are adhered to. The County should also review their procedures for the issuance of these independent contracts to ensure compliance with the State and County procurement code.

**Management Response:**                      We concur with these findings and recommendations. The County will provide the appropriate guidance to all departments and agencies to ensure that all goods and services for which an independent contractor may be required will be first referred to the Division of Purchasing for procurement review. A determination will then be made as to the appropriate procurement and award methodologies based on the goods and services to be acquired.

**End Date:**                                              On-Going

**Responding Person:**                              Ernest W. Barreira, M.S., Budget & Purchasing Director  
Phone: (808) 241-4295

**Ref No. 12-02                      IMPROVE INTERNAL CONTROLS OVER THE Pcard PURCHASES**

**Auditor's Recommendation:**                      The County should review their policies and procedures and strengthen their internal controls over the use of the pCard. These policies and procedures could include mandatory training for all personnel handling the pCard transactions at the various departments and agencies; continuous monitoring pCard transactions to ensure proper procurement procedures are followed; and implementation of violation reports and consequences for departments and agencies not following the established procedures.

**Management Response:**                      We concur with the findings and recommendations of the auditor. General Commodities P-card Policies and Procedures are being finalized for distribution to all County departments and agencies. Formal procurement re-training will be provided to all County department heads and fiscal/accounting personnel by the Division of Purchasing to ensure a comprehensive understanding of the small purchase requirements as applicable to the p-card threshold of under \$1,500. The varying roles and responsibilities of the p-card personnel within all departments will also be addressed and reviewed (e.g. p-card coordinators, fiscal personnel, etc.). Procurement methodologies, internal controls, and approval and documentation requirements will be clarified and enforced.

End Date: On-Going

Responding Person: Ernest W. Barreira, M.S., Budget & Purchasing Director  
Phone: (808) 241-4295

**Ref No. 12-03 PROPERLY ACCOUNT CONTINGENCIES**

Auditor's Recommendation: The County should establish procedures to ensure that loss contingencies are properly accounted for and is timely communicated to the Accounting Division for proper accrual in the County's financial statements.

Management Response: We concur with the finding and recommendations of the auditor. The Director of Finance has since met with appropriate legal and Department of Public Works staff on this matter. The Director of Finance will notify and advise department and agency heads to inform the Department of Finance of potential loss contingencies that are considered probable and reasonably estimated so that these costs could be properly accrued in the county's financial statements.

End Date: On-Going

Responding Person: Wallace G. Rezendes Jr., Director of Finance  
Phone: (808)-241-4200